No. 14760

In the United States Court of Appeals for the Ninth Circuit

JACK SHOWELL AND DOROTHY SHOWELL, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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CITATIONS

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 11-27) are reported at 23 T. C. 495.

JURISDICTION

The Commissioner determined that there were deficiencies in the individual income taxes of Jack Showell and Dorothy Showell for the year 1949 in the amounts of $3,946.65 and $4,065.69 respectively. Notices of these deficiencies, dated February 26, 1953 (R. 6, 121), were mailed to the taxpayers individually. Individual petitions for redetermination of these deficiencies were filed in the Tax Court by each of the taxpayers, within the permitted 90-day period, on April 30, 1953, under the

provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3, 4-6, 121.) On January 26, 1955, the Tax Court entered decisions that there were deficiencies in the income tax for the year 1949 of Jack Showell and Dorothy Showell in the amounts of $3,286.65 and $3,392.25, respectively. (R. 27-28.) Separate petitions for review by this Court were filed by each of the taxpayers on March 9, 1955. (R. 29, 121.) Accordingly, this Court has jurisdiction of these cases under the provisions of Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court's finding that the taxpayers did not sustain gambling losses in 1949, in the amount claimed by them, is supported by the evidence.

2. Whether the Tax Court abused its discretion in refusing to admit into evidence certain testimony, relating to the expenditures of the taxpayers during the taxable year, which was objected to as being irrelevant and immaterial to the question of whether the taxpayers sustained gambling losses in that year.

STATEMENT

The facts, as found by the Tax Court, are as follows:

The taxpayers, husband and wife, filed individual income tax returns for the year 1949 with the Collector of Internal Revenue for the District of Arizona. Interest income, rental income and income from a partnership were reported on these returns; no income was reported from or loss was deducted with respect to wagering operations. (R. 12.)

During 1949, the taxpayer, Jack Showell, was engaged in booking bets on baseball, football and basketball games. About 90 per cent of the bets taken by

Showell was made over the telephone and no receipts or tickets were given for the money wagered. Most of the bettors were known to Showell and credit was extended by him, in some instances, to persons who he thought were good risks; other bettors were required to pay him the amount of their bets prior to his acceptance of the bet. He received both cash and checks in payment of the bets. (R. 12.)

Bets were accepted by Showell on either of the two teams participating in a baseball, basketball or football game at odds of six to five. A bettor was required to put up six dollars to win five dollars. "Point spreads" were used to attempt to place both teams on an equal basis for betting purposes. If an equal amount of money was bet on each of the teams in a particular game, Showell would lose one bet of five dollars and win one bet of six dollars, realizing one dollar profit for each twelve dollars bet on the game. The element of risk for Showell increased when more money was bet on one team than on the other. (R. 13.)

Showell made notations of each bet on a small slip of paper or on a sheet called a "tally sheet," which was used for persons making several bets. (R. 13-14.) Initials were used to identify the bettors, from which only Showell could determine who the bettors were. (R. 14.) After a game had been played, Showell marked each of the slips and tally sheets with an "X" to indicate losing bets, and a circle to indicate winning bets. At the end of the day or week, depending on which type of game was involved, the slips and tally sheets would be totaled to determine whether the day's or week's activities resulted in a net gain or net loss to Showell. Showell generally followed the procedure of reading separately the results of all of the winning

bets and all of the losing bets to one Houston L. Walsh, a man who shared Showell's office. Walsh added them on an adding machine. The total of the winning bets was set off against the total of the losing bets and a net gain or loss was determined. A similar procedure was followed with Walsh reading from the slips and sheets and Showell using the adding machine. (R. 14.) The results thus obtained were entered on a sheet of columnar paper, entitled "Sports—1949," which was submitted in evidence as Exhibit 3. (R. 14-15, 44.) If amounts received from losing bettors exceeded amounts paid to winning bettors, the amount of the excess was entered opposite the date under the column headed "Gain." If the converse was true, the amount of the excess of losses was entered under a column entitled "Loss." (R. 15.) This was the only record of bookmaking losses retained by Showell; sometime after the day's results were entered and all claims had been cleared the slips and tally sheets were destroyed by Showell. (R. 14, 16.) Showell also kept sheets showing the amounts of bets owed to him by bettors, which, at the end of the year, were added to ascertain the total amounts owed him. (R. 16.)

Six amounts reflecting items other than gains or losses were shown on Exhibit 3. Four of these were as follows: $125 for rent; $59.40 representing payment to Western Union for services; $60 for payment to Athletic Publications, Inc., an information service on football teams; and $100.82 for telephone service. Items of $2,447.50 and $1,350, entered on December 31, represented amounts which Showell determined to be owed to him by bettors. These amounts were placed in the "Loss" column of Exhibit 3. (R. 16-17.) The exhibit,

with these amounts entered as losses, reflected a net loss for the year in the amount of $581.09. (R. 15-16.)

The income tax returns of the taxpayers for the year 1949 were investigated by a revenue agent who was furnished the data shown on "Sports—1949." The agent was unable to obtain from Showell any data or records which would enable him to verify any of the amounts shown on the summary sheet. He was advised by Showell that he had no other books or records with respect to the bookmaking transactions. Although Showell retained cancelled checks issued by him in payment to certain winning bettors, he informed the agent, who had requested the names and addresses of persons to whom he had paid winning bets and the amounts of such bets, that he was unable to furnish that information. The checks were not shown to the agent or any representative of the Commissioner prior to the hearing in the Tax Court. (R. 17-18.)

The Commissioner determined that Showell had income of $22,908.88 (the amount shown in the "Gain" column of "Sports—1949") from wagering operations and allowed as deductions the amounts of the four expense items referred to above. One-half of the net gain thus computed was determined to be taxable to each of the taxpayers, and the deficiencies were thus determined. (R. 18.)

The Tax Court found that Showell sustained gambling losses of $3,000 in addition to those allowed by the Commissioner. (R. 18.)

SUMMARY OF ARGUMENT

The basic issue presented to the Tax Court was whether the taxpayers' record of bookmaking activities, entitled "Sports—1949," accurately listed amounts as

net losses incurred on wagers on listed days. This factual issue turned on the question of the credibility of the record and of testimony by Jack Showell, one of the taxpayers, to the effect that the record accurately contained the results of bookmaking transactions. The Tax Court was correct in treating this case, and similar cases, as turning primarily on their individual facts. And since the evidence fully supported the Tax Court's findings herein, the decision of the Tax Court should be affirmed.

No error was committed by the trial judge in the Tax Court in excluding from evidence testimony of Jack Showell relating to his expenditures for the taxable year. Such evidence was irrelevant and immaterial since it was far too remote from the basic issue of whether losses were sustained. The remoteness of the type of evidence offered, the apparent deficiencies in the net worth method, the burden placed on the Commissioner, and the possibility that the trial might be unnecessarily prolonged if such evidence were admitted, when coupled with the fact that the evidence offered would stand in no better light than Jack Showell's testimony that the summary sheet accurately reflected his income from bookmaking, make it obvious that the trial judge exercised his sound discretion in ruling that the evidence was inadmissible.

ARGUMENT

I

The Decision of the Tax Court that the Taxpayers Did Not Sustain Wagering Losses in Amounts Claimed by Them Is Amply Supported by the Evidence and Should be Affirmed

As in most cases, the broad issue presented to the Tax Court in the instant case was whether the taxpayers

realized income in excess of that reported on their income tax returns. The Commissioner had determined that the taxpayers had received income from bookmaking activities in the amount of $22,563.66, which was not reported on their return. This determination was made by utilizing the taxpayers' only record of bookmaking activities, a summary sheet entitled Sports —1949, which was introduced into evidence as Exhibit 3. (Appendix, *infra;* R. 44.) This record consisted of columns headed "Gain" and "Loss," in which, opposite listed dates, various amounts purporting to represent the net results of bookmaking activities on the date listed, were set forth. The Commissioner, in determining the deficiencies asserted, accepted as true all of the amounts listed, and, except in minor respects,[1] disallowed all of the net losses appearing on the summary sheet for lack of substantiating evidence.

The taxpayers did not dispute the accuracy of the "Gain" amounts shown on the summary sheet, but contended that the Commissioner's disallowance of the "Loss" items similarly appearing on the sheet was erroneous. The basic issue presented to the Tax Court, then, was whether the summary sheet accurately recorded the results of the taxpayers' bookmaking activities for the year 1949.

The Tax Court, reviewing the Commissioner's determination, also accepted the amounts set forth on the

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[1] Four items appearing in the "Loss" column were accepted by the Commissioner. These appeared on December 1, December 14 and December 22, and represented amounts paid for rent, to Western Union, to Athletic Publications, Inc., an odds-furnishing service, and for telephone expense. The taxpayers had cancelled checks showing payment of all of the above amounts except the amount stated for rent. (R. 65, 66, 67.) None of these items are now in dispute.

summary sheet as "Gain," but did not give credence to the amounts contained in the "Loss" column. However, the Tax Court, with two judges dissenting,[2] found that the taxpayers did sustain some losses in addition to those reflected in the net amounts of gains and, apparently on the theory of *Cohan* v. *Commissioner,* 39 F. 2d 540 (C. A. 2d), found such losses to be in the amount of $3,000. It is submitted that the Tax Court's decision was correct and should be affirmed.

The Tax Court has consistently treated this type of case as presenting solely factual issues and decided each case on the basis of facts adduced therein.[3] That this is the proper treatment is manifest when it is considered that the issue presented is essentially one in which credibility is the deciding factor. If the Tax Court chose to believe that the taxpayers' record of gambling activities, the summary sheet, was an honest and faithful record of those activities, the issue would have been resolved in the taxpayers' favor. On the other hand, in a case such as the instant one, where the Tax Court is not of that mind, the losses appearing on the summary sheet are properly disallowed. It is precisely in this type of situation that the Tax Court's find-

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[2] The dissenting judges thought that no additional losses should have been allowed to the taxpayers, since they failed to keep the records required of them by the Internal Revenue Code.

[3] The Tax Court's consistent method in deciding similar cases on the basis of facts presented in each is illustrated by the following cases which reach varying results: *Rainwater* v. *Commissioner*, 23 T.C. 450; *Nemmo* v. *Commissioner*, 24 T.C. No. 67; *Nellis* v. *Commissioner,* decided February 28, 1955 (1955 P-H T.C. Memorandum Decisions Service, par. 55,050); *Robert Fogel* v. *Commissioner*, decided June 30, 1955 (1955 P-H T.C. Memorandum Decisions Service, par. 55,185); *Max Fogel* v. *Commissioner*, decided June 30, 1955 (1955 P-H T.C. Memorandum Decisions Service, par. 55,186); and *Clark* v. *Commissioner*, decided September 7, 1955 (1955 P-H T.C. Memorandum Decisions Service, par. 55,252).

ings should remain undisturbed unless clear error appears. *United States* v. *Gypsum Co.*, 333 U. S. 364, rehearing denied, 333 U. S. 869; *Ward* v. *Commissioner*, 224 F. 2d 547 (C. A. 9th). And we submit that no such error exists, in the instant case, but rather that the findings of the Tax Court are amply supported by the evidence.

The chief witness presented by the taxpayers in the Tax Court was Jack Showell, one of the taxpayers. He gave testimony relating to the general manner in which his bookmaking business was conducted, which was not challenged in any manner by the Commissioner; this testimony also formed the basis for many of the findings of fact made by the Tax Court. In addition, Mr. Showell's testimony concerned the manner in which the summary sheet entitled "Sports—1949" (Exhibit 3) was prepared and its accuracy. It was this testimony which was challenged by the Commissioner on cross-examination and was rejected by the Tax Court as self-serving. (R. 20.) There can be no doubt on reading Mr. Showell's testimony relating to these matters that the Tax Court was plainly justified in not choosing to believe that the summary sheet was accurate.

Mr. Showell testified, on cross-examination, that although he had checks and check stubs showing amounts paid to bettors, he had never made them available to the examining revenue agent (R. 87-89, 97-98) although the agent had requested Showell to turn over to him any proof substantiating the claim that the losses had been incurred (R. 55-56). Moreover, Mr. Showell testified that he never furnished any of the names and addresses of bettors on whose bets he had incurred losses to the revenue agent, although such names were requested, presumably because the agent had asked for *all* of the

names of such persons and Showell would have only been able to furnish some names. (R. 89.) This, of course, made it impossible for the agent to check, to any extent, the accuracy of the statements appearing on the summary sheet.[4] Certainly these factors, coupled with the fact that Mr. Showell was, to say the least, a highly interested witness, are sufficient reason for the Tax Court to refuse to believe his testimony on this crucial issue.

Three other witnesses, H. L. Mende, Huston L. Walsh and C. E. Leech, appeared on behalf of the taxpayers. Mr. Mende, a revenue agent, testified concerning the manner in which the deficiencies were determined. His testimony, in no way, attempts to prove the existence of the losses.

Mr. Walsh testified (R. 110-115) that he assisted Showell in totaling the results of the betting during the year 1949. His testimony was confusing[5] and taken most favorably to the taxpayers tends to prove only that there were slips showing each bet which were used in preparing the summary sheet. However, he did not prepare these slips and could not, in any way, vouch for their accuracy.

Mr. Leech testified (R. 115-116) that at the end of 1949 he owed Showell about $1,350 as a result of bets which he lost. This testimony corroborated an amount

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[4] The Tax Court might also have wondered about the apparent inconsistency between Mr. Showell's testimony that he took bets on basketball games (R. 59, 60, 91, 100), and his testimony that he did not take bets between January and September (R. 91) apparently to corroborate the lack of any gains or losses on Exhibit 3 for that period, while the basketball season extends through February.

[5] The transcript does not make it clear whether Mr. Walsh actually saw the figures on each of the betting slips. (See R. 111, 112, 114, 115.)

shown on an adding machine tape appended to the summary sheet. Since, however, the Tax Court found that the taxpayers sustained additional losses of $3,000, it must be assumed that this testimony was taken into account in making that finding.

The taxpayers complain (Br. 8) that the Tax Court could not accept the amounts shown on the summary sheet as "Gains" while at the same time refuse to accept the accuracy of the amounts shown as "Losses" since some losses went into the computation of the "Gains." The Tax Court, however, was clearly justified in believing that the amounts shown as gains were at least accurate to the extent admitted by the taxpayers. As the Tax Court said (R. 20):

> These gain figures, in a sense, were admissions against interest by the petitioners and so were more reliable than the bare "Loss" figures carried in the other monthly columns on the exhibit.

It must be remembered that the taxpayers were under an obligation pursuant to Section 54 of the Internal Revenue Code of 1939 to maintain books and records. The purpose of this code provision is apparent; there must be some records available which will enable the Commissioner to determine whether income has been properly reported. Here, the "record" kept by Jack Showell is really no better than a mere statement on a return that a taxpayer realized income in a specified amount. For this reason, it has been held that a taxpayer has the burden of proving his right to take deductions and their amount. *Burnet* v. *Houston,* 283 U. S. 223. In a case such as this, the Commissioner is placed in a difficult position where he has really no means available for substantiating the existence of the

taxpayers' losses. Cf. *Burka* v. *Commissioner,* 179 F. 2d 483 (C. A. 4th). We submit that the Tax Court in treating each individual case presenting this kind of problem as a factual issue is adopting the only reasonable course open to it. And, in refusing to accept the self-serving testimony presented herein to prove the losses claimed, the Tax Court was properly exercising its prerogative as a trier of fact. Cf. *Chesbro* v. *Commissioner* (C. A. 2d), decided August 9, 1955 (1955 C. C. H., par. 9602).

II

The Tax Court's Refusal to Admit Certain Evidence Relating to the Expenditures of the Taxpayers Was a Reasonable Exercise of Its Discretion to Exclude Irrelevant and Immaterial Evidence.

The taxpayers complain that the refusal of Judge Withey, who presided at the trial below, to admit testimony relating to their net worth and expenditures as some evidence of the incorrectness of the Commissioner's determination is reversible error. (Br. 14-17.) The Commissioner's objection to the line of testimony being adduced by the taxpayers was that such testimony was immaterial and irrelevant. (R. 85-86.) We submit that the trial judge's action in sustaining this objection was a proper exercise of his discretion.

In reviewing questions relating to the propriety of the admission or exclusion of evidence, objected to on the grounds of relevancy and materiality, the appellate court should not inquire as to whether it, in the position of the trial judge, would have admitted or excluded the proffered evidence. Rather, the issue is whether there was a clear abuse of the discretion vested in the trial judge in ruling on such questions. II Wigmore, Evidence, Section 444; American Law Institute, Model

Code of Evidence, Rule 303; *Atlantic Coast Line R. Co.* v. *Pidd,* 197 F. 2d 153 (C. A. 5th), certiorari denied, 344 U. S. 874; *Newman* v. *Clayton F. Summy Co.,* 133 F. 2d 465 (C. A. 2d). It can readily be seen that there was no such abuse in the instant case.

The use of the net worth method for determining income has been upheld in criminal tax cases (*Holland* v. *United States,* 348 U. S. 121) as well as civil tax cases (*Lipsitz* v. *Commissioner,* 21 T. C. 917, affirmed, 220 F. 2d 871 (C. A. 4th), certiorari denied October 10, 1955). However, it has been made clear that many problems arise in the use of that method by the Government and that care must be taken to insure that the rights of the taxpayers are not jeopardized. *Holland* v. *United States, supra.* This should be no less true when its use is attempted by a taxpayer in a civil case to overcome his burden of proof.

Traditionally, it is within the Commissioner's power to determine the correct method for the computation of income, and it must be remembered that the Commissioner in instances where he resorts to the net worth method is, in a sense, compelled to do so by the taxpayer's failure to keep records which are accurate or verifiable. Its use should be sparingly allowed to taxpayers who place themselves in a position, as did the taxpayers herein, where it is impossible to provide the Commissioner or the Tax Court with any means of substantiating a wholly inadequate record.

Moreover, the accurate proof of income by such circumstantial evidence very often results in long, complicated, burdensome and confusing trials. In a situation where the taxpayer seeks to introduce this kind of evidence into a trial, it is properly within the discretion of a trial judge to weigh the possibility of such an un-

desirable result against the effect of exclusion of the submitted evidence. And in cases such as the instant one where the Commissioner's agents may not have conducted their investigations with a view toward ascertaining the net worth and expenditures of the taxpayers, the Commissioner, at the trial, may be placed in the position of being unable, because of lack of information, to question the taxpayers' computations. An almost insuperable burden would be placed on the Commissioner if, in each investigation or audit of a taxpayer's returns, it were necessary to conduct a net worth and expenditure investigation in order to prepare for the possible use of that method by the taxpayer in the event of litigation.

Finally, the nature of the excluded evidence clearly shows that its exclusion resulted in no real prejudice to the taxpayers' case. There were introduced into evidence comparative balance sheets of Jack Showell as of December 31 of the years 1947, 1948 and 1949. (R. 76.) No offer of evidence, either documentary or testimonial, was made to explain or substantiate the amounts appearing on the exhibit, except testimony of Mr. Showell. After he had testified concerning the amounts shown on the exhibit, he was questioned about automobile expenses, and expenses for a maid. (R. 85.) He was then asked about the cost of buying food for his family; at this point the Commissioner objected (R. 85-86) and the objection was sustained (R. 86). This was the only evidence offered that was excluded. Since no other offer of proof was made, it must fairly be assumed that any additional evidence of expenditures would also have been elicited from Mr. Showell. The evidence excluded was self-serving and was intended to corroborate other self-serving testimony of Mr.

Showell about the accuracy of his summary sheet. Certainly, this additional testimony of Mr. Showell is subject to the same disabilities that were inherent in his other testimony. The trial judge could, therefore, reasonably exclude such testimony since it added nothing whatever to the case. If the Tax Court chose not to believe Mr. Showell's testimony about Exhibit 3, his attempt to corroborate his previous testimony, by additional testimony in a different vein, would stand in the same light. It was, therefore, not reversible error for Judge Withey to exclude the evidence proffered but rather was a reasonable exercise of his discretion.

CONCLUSION

The decision of the Tax Court should be affirmed.

Respectfully submitted,

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November, 1955.

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REPORTS — 1949

		Gain	Loss
Jan	1	39500	—
Sept	17	—	88250
"	24	—	9710
Oct	2	34935	—
"	8	—	657195
"	9	68600	—
"	15	—	136360
"	22	321100	—
"	29	—	202600
Nov	5	376755	—
"	13	—	434650
"	19	107970	—
"	20	—	124110
"	27	40260	—
Dec	3	101673	—
"	3	—	45000
"	5	2000	—
"	6	4300	—
"	7	2100	—
"	1 Rent	—	12500 X
"	9	51000	—
"	10	—	27450
"	11	57000	—
"	12	37200	—
"	13	—	90200
"	14 W.J.	—	59.[illegible] ✓ X
"	14	10+[illegible]	—
"	15	15315	—
"	16	—	70500
"	17	58400	—
		2002088	

cks ✓

		Gain	Loss
Dec	18	—	48700
"	19	85900	—
"	20	79600	—
"	21	9600	—
"	22	3100	—
A.P. "	22	—	6000 ✓
Tele "	22	—	10052 ✓
"	23	110600	—
"	31	—	244750
Leech	31	—	135000
		2889.00	444532
		2002088	1904465
		2290888	23489.97
			2290888
			−581.09

LOSS

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JL. [illegible]
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